Date : ___/___/___

National Income & Related Aggregates

Circular flow of Income

* Short Answer Questions

1) Explain circular flow of income?

Ans Circular flow of income refers to cycle of generation of income in the production process, its distribution among the factors of production & finally its circulation from households to firms in form of consumption expenditure on goods & services produced by them.

2) What are the different phases of circular flow of income?

Ans Three Phases of circular flow are :—

1) Production Phase / Generation Phase
In this firm produce goods & services by various factors of production

2) Distribution Phase — This involves flow of income from firms to household means the payment of factors of production.

3) Disposition Phase :— The income recieved by factors of production, by selling them.

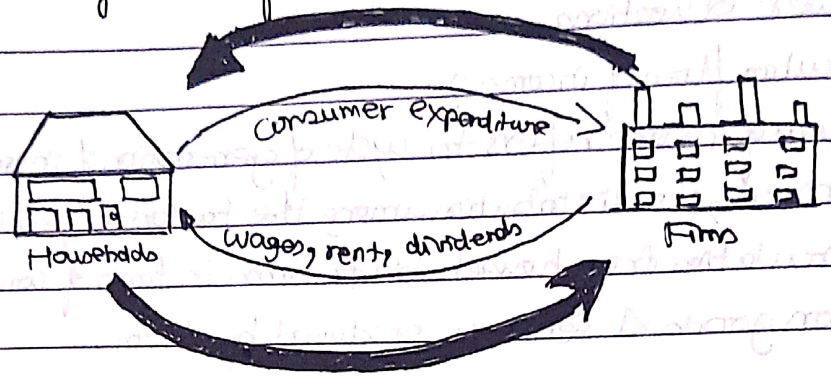
3) Distinguish between Real flow and Money flow?

Basis	Real Flow	Money Flow
Meaning	It is flow of goods & services between firms & households.	It is flow of money between firms & house holds.
Kinds of exchange	Exchange of goods & services	Exchange of money
Difficulty in Exchange	There may be difficulty in barter system	There is no difficulty in money exchange
Alternative Name	Physical flow	Nominal flow

Date : ____/____/____

4) Households & firms depend on each other in circular flow of income. Justify in case of two sector model.

Ans)



Households & firms depend on each other in circular flow of income in case of two sector model so there has been the flow of money from households to producer as payments for purchase of consumergoods & services. This non stop continuity of internal sector flows is called circularity of flows.

5) Distinguish between Stock & flow?

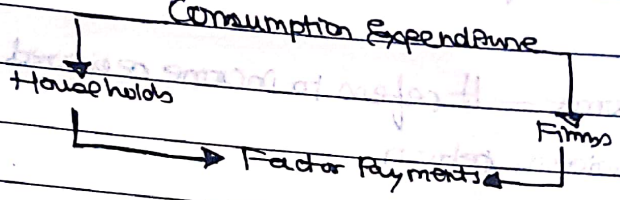
Basic	Stock	Flow
Meaning	Stock variable refers to variable which is measured in particular point of time.	Flow variable refers to variable which is measured over period of time.
Timedim	It does not have time dimension.	It has time dimension as measured over period of time
Nature	It is static concept	It is dynamic concept.
Example	Population of India in 31/3/9	Population of India in 2009

Date : / /

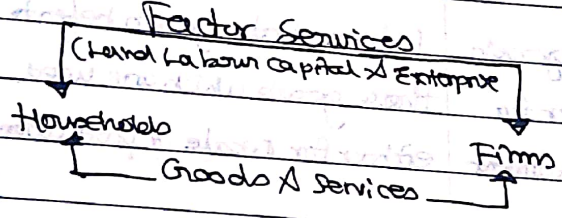
Long Answer Question

1) Briefly explain money flow & real flow of income.

Ans Money flow refers to flow of income from firms to households for their factor services & corresponding flow of consumption expenditure from households to firm for purchase of goods & services produced by firm.



Real flow refers to factor services from households to firm & the corresponding flow of goods & services from firms to households.



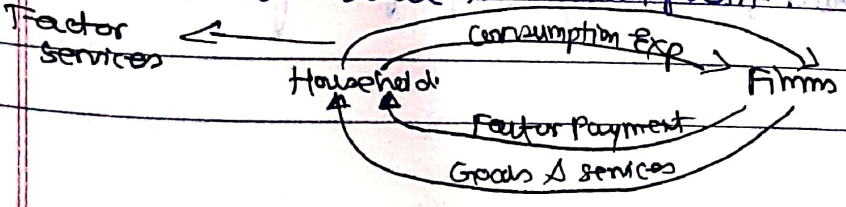
2) Describe the circular flow in income in two sector economy?

Ans Simple economy assumes 2 sectors:-

1) Households — Households are owners of factor production & consumers of goods & services

2) Firms — Produce goods & services to sell them to Households.

Household sector supply factor services only to firms & firms hires factor services from households. Firms produce goods & services & sell their entire output to households. Households recieve factor income for their services & spend entire amount on consumption of goods & services. There are no savings in economy neither household save from their income nor firms save them from profit.



Date : ___/___/___

Chapter-2
Basic Concept of Macroeconomics

1) Distinguish between factor income & transfer receipt?

Ans Payment received or income by factors of Productions for rendering factor services in production process is called Factor Income.

Transfer Income — It refers to income received without rendering any productive service in return.

2) Distinguish between intermediate products or final products?

	Final Goods	Intermediate Goods
1)	It refers to those goods which are used either for consumption or for investment	Intermediate goods refers to those goods which are used either for resale or production
2)	Included in both national & domestic income	It is not included in any of the incomes
3)	They have Direct Demand	They have derived demand
4)	They are ready to use	They are not ready to use
5)	Crossed Production boundary	Within Production boundary

3) Machine purchased is always final good. Do you agree

Ans No It depends on end use of machine. If it is purchased by a household it is outrightly a final good. It is like a consumer durable If purchased by retailer from factory for purpose of resale it is intermed

Date : ____/____/____

4) Distinguish between consumer goods & capital goods. Which of these are final goods.

Ans

Consumption Goods	Capital Goods
These goods satisfy human wants directly so such goods have direct demand.	Such goods satisfy human wants indirectly so derived demand
2) They do not promote production	They promote production
3) Have limited expected life except durable goods	Have expected life of more than 1 yrs.

5) What is meant by Net factor Income from abroad? Discuss its various component?

Ans Net factor income from abroad refers to difference between factor income received from rest of world & factor income paid to rest of the world.

Components of NFIA

1) Net compensation to Employees
2) Net income from property & Enterpreneurship
3) Net retained earnings.

Long Answer Questions

1) Explain concept of Normal residents

Ans It's one who resides in the country concerned & whose centre of economic interest lies in that country. A person is said to have his economic interest when he conducts his economic transaction in country on significant scale.

2) Briefly discuss meaning of Domestic territory?

Date : ____/____/____

Ans Domestic Territory means political frontiers of the country in layman language.

Domestic Territory also includes

1) Ships & aircrafts owned by normal residents between two or more countrys.

Plans operated by Air India b/w Russia & Japan are part of Domestic Territory of India

Plans operated by Singapore Airway b/w India & Japan is part of Domestic Territory Singapore.

2) Fishing vessels, oil & natural gas operated by residents of country in International waters as they have exclusive rights of operation.

Fishing boat operated by Indian Fisherman in International waters of IO

3) Embassy, consulates & military establishment of country located abroad — Indian embassy in Russia is part of India.

3) Discuss the concept of factor Income & transfer income with help of examples

Ans Factor Incomes

a) Its bilateral (2 sided)

b) Are related to factor of services or factor of Production (Land, Labour, Capital, Enterpreneurship)

c) Ex — Compensation of Employees, rent, interest, profit

Transfer Income

1) Are unilateral

2) Not related to any kinda work

3) Ex — Charity grant

Date : ____/____/____

4) Ans. Differentiate b/w Intermediate & final goods.

Final goods	Intermediate goods
Which are used for consumption or for investment	Which are used for production or further resale
Included in both net & dom income	Not included in any income
Direct Demand	Derived Demand
Crossed Production boundary	Within Production boundary

Date : ___/___/___

Chapter-3 and Chapter 4
National Income & Related Aggregates

4) Calculate GDP at MP

National Income	- 6700
+ Dep	180
+ NFIA	+50
+ NIT	+ 60
	6990

5) Calculate Domestic Income. (NDP_{FC})

GNP	- 2700
- Dep	150
- NFIA	+ 30
NDPFC	2580

6) Calculate GNP at FC

NDP at MP	80,000
Net factor from abroad	80,000
Dep	4950
Subsidies	1980
Indirect Tax	10,600
GNP_{FC}	75920

7) Calculate Domestic Income

GNP at MP	58,350
ID	2,590
Subsidies	1540
Dep	1625
NF from Abroad	-240
NDP_{FC}	55915

Date : ___/___/___

8) Calculate Domestic Income

GDPMP	70150
- Dep	3100
- NIT	1200
NDPFC	65250

4) National Income

GDPMP	70150
- Dep	3100
- NIT	1200
NNPFC	66350

10) Calculate NDP at MP

Sales - 90
C/S - 25
O/S - 15
IT - 10
IC = 40
Purchase of Raw material - 15
Rent - 5

Ans GVA MP = Value of output - IC

Value of output = Sales + change in stock = 90 + 10 = 100

IC = 40

Sales + change in stock - IC

GDPMP = 90 (10) - 40 = 60

NDPMP = 60 - 20 = 40

11) Calculate Nat income - NNPFC

GDPMP	4800
- Dep	-200
+ NIA	80
- NIT	240
NNPFC	4440

Date : __/__/__

12) Given

GNP$_{MP}$ = 65000

Dep = $120000 \times \frac{10}{100}$ = 12,000

ID = 6000

Subsidies = 1000

GNP$_{MP}$	65000
− Dep	− 12000
− NT	− 5000
NNP$_{FC}$	48000

Practicals of value added method.

i)	Sales by firm A	100
ii)	Purchase from firm B by firm A	40
iii)	Purchase from firm A by firm B	60
iv)	Sales by firm B	200
v)	C/S of firm A	20
vi)	C/S of firm B	35
vii)	O/S of firm A	25
viii)	O/S of firm B	45
ix)	ID paid by both firms	30

Ans Val of output = Sale + change in stock

= 100 + (−5) = 95

Value added − value of output

= 95 − 40 = 55

firm B

Val of output = Sales + change in stock

= 200 + (−10) = 190

Value added = value of output

= 190 − 60

= 130

Date : ____/____/____

Value of output = Sales + change in stock
= 200 + 10 = 210
GVAMP = value of output = 210 - 90
GVAMP = 120
- Dep
- NIT
108

Value of output = Sales + change in stock
= -20000 + (-500)
= 19500
GVAMP = value of output - IC
= 19500 - 10900
GVAMP = 8500
Net indir = 50
NVAFC 8450

q) Value of output = Sales + change in stock
= 16000 + (-500)
= 15500
8000
GVAMP = 7500
- Dep = 1000
6500

q2 Value of output = Sale + change in stock
= 25 + (-2)
GVAMP = 23 - 6
= 17
Dep = -3
NVAMP 14
Value of output = Sale + change in stock
= 100 (-10)

Date : ___/___/___

Q) Calculate operating surplus.

1) Compensation of employees	200
IT —	200
Subsidies —	50
GDP at Mp	600
Operating surplus.	150

Q) Indirect Taxes 250
Royalty 20
Profit 200
Subsidies 50
Rent 100
Interest 50
GDP at Mp 1870
Compensation of employees 1120

Q) Calculate Indirect Taxes from following DATA
GNp = NDPFc + Dep + NFIA + NIT
58350 = 55915 + 1625 + (625 - 825) + (Indirect taxes - 1540)
58350 = 2540

Q) Calculate FITA
FITA = NDPMP + Dep + FIFA - GNPFC - IT - Subsidy
FITA = 3700 + 480 - 4780 - 100 + 80
FITA = 280

Q) Calculate Depreciation
GNPFC = NDPMP + Dep + NFIA - NIT
75920 = 80,000 + Dep (500 + 700) - 11060 - 1770
Dep = 75920 - 70970
Dep = 4950

Date : ___/___/___

Q/ Calculate subsidies
GNPFC = NDPMP + Dep - NFIA - NIT
$5000 = 6550 + 2500 + 700 - (4400 - subsidies)
5000 = 6240 + subsidies
Subsidies = 2100

Income Method

1) GOE
2) Salary + wages + Non monetary (wages in kind + free car) + Pension + Social security schemes

2) Operating Surplus - Rent + Royalty + Int + Profit (Corporate business / Profit tax + Dividend + Retained earnings / Undistributed Profit)

Q) Calculate NDP FC
Rent - 400
Royalty - 200
Int - 500
Profit 500
COE - 1000
MI - 1000
NDP FC = 10000 + 400 + 200 + 500 + 500 + 100 = 3600

Q) COE - 13,300
Wages in kind - 200
IT - 3800
Gross Domestic formation - 6200
Operating Surplus - 5000
Net factor income from abroad - 300
Net export = - 100
Calculate National Income or NNP at FC

Date : ___/___/___

Q) Calculate NNP at FC

i)

Ans NDP FC

= 600 + (20) − 160 + 60 + 280

= 840 + 280 = 1120

NNP Fc

=> NNP (fc) d NFIA

=> 1120 + (−20)

=> 1120 + 20

=> 1140 crore

ii) 800 + 100 + 200 + 500 + 30 − (−20) + 70

= 1270

Personal tax Personal Income

= 1200 + 150

Personal income − 1350 crore

Q) COE = 2000

Intr − 500

Rent − 700

Profit − 800

Employment to SSC − 201

Dividend − 300

Depreciation − 100

NIT − 200

Net export − 70

Net Factor IA − 150

Net Income − 1500

Calculate GNP at MP

NDP Fc = 2000 + 500 + 700 + 800 + 1500

= 5500

Date : ___/___/___

GNP MP = 5500 + 100 + 250 − 150 = 5700

GNP MP = NDP FC + Dep + NIT − NFITA

NDP FC = COE + Int + Rent + Profit + MI

25) GDP at MP

NDP at FC = COE + OS + MI = 350 = 200 + OS

GDP MP − Dep − NIT

600 − 100 (200 − 50) = 150

26) GDP at MP

OS = Rent + Royalty + Int + Profit

= 100 + 200 + 50 + 200 = 350

GDP at MP

NDP at FC = GDP at MP − Dep − NIT

1800 − 200 (250 − 50) − 200 = 1400

NDP at FC = COE + OS + MI = 1400

Date : ___/___/___

Expenditure method

Value add
Income method
Expenditure method.

Sum total of all expenditure done by (Household, Govt, financial, institution, firm)

Components
PFCE + GFCE + Gross domestic capital = NDP at FC

PFCE = Expenditure done by household (final goods. durable, semidurable

GFCE = Expenditure done to promote service to people construction of Road, defence etc.

Gross Domestic capital formation
Public & Govt Sector both
Gross Buisness fixed Investment (When we Invest on fixed asset) Machine, Plant, Equipment
[ ] + Dep

2) Gross Residential Construction
Investment Household

3) Gross Public Investment - Flyover

Gross Domestic capital formation = GFCD + Inventory investment (change in stock)

Date : ___/___/___

Net exp = Export − Import

NDP at FC + NFIA = NNP at FC

PPCE − 27500
GFCE − 3000
GDCF − 2500
Import − 5500
NFIA = −200
Subsidies − 200
Fall in stock − 300
Exp − 4500
Dep − 1000
NIT = 100
GNP at MP
NDP at FC

NDP at FC = 33000
GNP at MP = 33000
1000
−200
+ 1500
34750

a) Calculate National income by A/I/3 method.

Value added
1600
2500
1200
5300 GDP MP

5300
− 800
4500
− 700
4100 NDP FC (Domestic)
4200 − Net income

Date : ___/___/___

Income method

1500
1000
450
550
600
4100 + 100 = 4200

Expenditure method

30000
600
1300
150
5300 − 500 − 700 + 100 = 4200

Q) GVA by Primary − 1600
GVA by Secondary Sector − 2000
GVA by Tertiary Sector − 1200
COE − 15000
Rent Royalty − 1000
Interest − 400
MI − 600
Profession − 500
PFCE − 3500
GFCE − 650
GDCF − 1300
Net export − 150
NIT = 700
Dep − 500
Net factor income from abroad − 100

4 May 20

Date : ___/___/___

Chapter – 4
Measurement of National Income
(Question Answers)

1) Discuss the concept of value added method.

Ans Value added refers to addition of value to raw material by a firm by virtue of its productive activities. It is the contribution of an enterprise to the current flow of goods & services.

2) What is meant by Problem of Double counting? How this can be avoided?

Ans The counting of value of commodity more than once is called double counting. It can be avoided by following.

1) Net exports should be excluded
2) Value of intermediate goods & services should be excluded
3) Capital consumption allowance should be excluded.

3) What precautions should be Taken while estimating national income?

Ans Some Precautions while estimating national income are.

1) Avoid double counting
2) Production of self consumption should not be included
3) Production of illegal activity should not be included
4) Sale of second hand good not included
5) Value of service rendered by family is not to be included

4) What is meant by compensation of employees? Discuss three elements of compensation of employees

Ans Employees compensation refers to benifits (cash, vacation) Cash compensation consisting of wages or salaries
Retirement plans (employer contributions) Employer paid health insurance

Date : ___/___/___

5) Define operating Surplus. State its components?

Ans Operating surplus is an accounting concept used in national accounts Statistics which refers to measure of surplus acquired from production of output before deducting property income from it like land rent & interest. It is component of value added & GDP.

Components are Surplus, Profit, Rent & Interest.

6) Explain mixed income of self employed & given an ex

Ans Mixed Income of self employed refers to surplus or deficit amount which is earned from production process by enterprises which are not Corporated. These type of enterprises are generally owned by members of household sector of economy. Mixed income is also known as operating surplus. For ex - Amount earned by members of household other than paid wages or salaries is known as Mixed income of self employed

7) What is meant by Gross Domestic capital formation? State its components

Ans GDCF refers to addition to capital stock of the economy. It represents the expenditure incurred on acquiring goods for use by production unit located within domestic territory.

Components.

1) Gross Fixed Capital Formation - (Exp on purchase of Fixed Asset)
2) Inventory Statement (Change in stocks)

Long Answer Type Questions

1) Explain production method of estimating national Income.

Ans Income method measure NI from side of Payments made to factors of production in form of rent, wages, interest & Profit for their productive services in an accounting year

Under income method NI is calculated by adding all factor Incomes generated by all Producing units located within the domestic economy during a period of account.

Date : ____/____/____

The resulting total is called Domestic Income. Further adding NFIA we get NNP_{FC}. In Income method NI is measured at a stage when factor incomes are paid out by enterprises to factors of production. Since net value added by enterprise is result of services of factors of production, therefore same is distributed as factor income in form of rent, wages, interest & profit among factors.

2) Discuss in brief various precautions of value added method?

Ans Precautions of value Added method are:-

1) Value on purchase & purchase of second hand good is not to be counted because it's already counted.

2) Commision on sale & purchase of second hand goods must be counted.

3) Value of Intermediate good is not to be included.

4) Self consumption is not estimated.

3) State any six precautions which must be taken while estimating factor income.

Ans Any 6 precautions which must be taken while estimating factor income

1) Transfer payments are not included in estimation national income.
2) Imputed rent of self occupied houses are to be included in calculating national income.
3) Illegal money are not included.
4) Windfall gains are not included.
5) Indirect taxes are not included while estimating national income @ factor cost.
6) Income equal to the value of production for self consumption should be estimated & included in NI.

Date : ___/___/___

4) Explain in brief the various components of expenditure method

Ans Various components of expenditure method are :-

National Income by Exp method

$= C + G + (X - M)$ where

C = Private consumption Exp of households

I = Gross Domestic Inv Exp

G = Govt Final consumption & investment expenditure

$(X - M)$ = Net export (Exp − Imp)

5) Discuss various steps of expenditure method for calculating NI

Ans The steps involved in calculating National Income by expenditure method are :-

1) Identify Economic Units Incurring Final expenditure

2) Classification of Final Exp : Final expenditures incurred by above mention economic units under following heads

1) Private Final Consumption Expenditure

2) Govt Final Consumption Expenditure

3) Gross Domestic Capital formation

4) Net Exports

The sum total of 4 component given GDP MP

3) Calculate Domestic Income (NDP FC) by subtracting Dep & NI

4) Estimate Net factor Income from Abroad (NFIA) to arrive at national Income.

5) NDP FC or Domestic Income + NFIA = NNP FC (National Income)

Date : __/__/__

10 May 2020

Chapter – 5
Money

Short Answer Questions

1) Discuss meaning of
   i) Currency & coins with Public
   ii) Demand Deposits held by commercial banks.

Ans(i) Currency & coins with public are physical form of money which are issued by the central bank of country & it is commonly accepted as a form of legal tender by whole country.

ii) Demand Deposits held by commercial banks are intangible forms of money which public deposit into banks which can be withdrawn any time at any place.

2) Give the meaning of i) Barter Exchange ii) Money iii) Money Supply

Ans Barter Exchange – Barter system was a system of exchange where goods was exchanged for goods & there was no common medium of exchange in economy. It had drawbacks like lack of Double Coincidence of wants, lack of common value, Difficult to store.

ii) Money – Common medium of exchange that is issued under law of govt and acts as a legal tender for whole country.

Functions of money :—

1) Common medium of exchange
2) Store of value
3) Common measuring unit
4) Serve as standard of Deferred Payments.

Date : ___/___/___

iii) Money supply refers to the total stock of money of all types held by people of a country at given point of time.

Long Answer Questions.

1) What is meant by money supply? Discuss in brief various constituents of money supply.

Ans Money supply refers to the total stock of money of all types held by people of the country at given point of time. Money supply is measured in several ways which includes M_1, M_2, M_3, M_4 measurement of money supply. Every measurement has its own definition with different components varying from most liquid to most rigid form.

1) $M_1 = C + DD + OD$

C — Currency held by public in terms of coin & paper notes.

DD — It refers demand deposits of the people with commercial bank.

OD — These includes other deposits with public financial institutions, foreign central banks & International financial institutions.

2) $M_2 = M_1 +$ Deposits with post office saving bank Account

3) $M_3 = M_1 +$ net time deposits with the commercial banks

4) $M_4 = M_3 +$ Total deposits with post office other than fixed National saving certificate.

Date : ___/___/___

2) Discuss the limitations of Barter exchange?

Ans Limitations of Barter Systems are:-

1) Lack of Double coincidence of wants
Barter system can work only when both buyer & seller are ready to exchange each other goods.

2) Lack of Common Measure of value - All commodities are not of equal value & there is no common measure of value of goods & services. In which exchange ratio can be expressed.

3) Lack of Standard Deffered Payment.
Under barter system contract involving in future payments or credit transaction don not takes places

4) Lack of Storage value - People exchage goods of different sizes that occupy much space & we cannot store it.

5) Indivisibility of goods - Its difficult to fix exchage rates for certain goods which are indivisible.

Date : ___/___/___

Today

Chapter - 6
Banking

Short Answers Questions

1) Explain the functions of Central Bank as a banker to government

Ans The central bank serves as banker to government both central & State. It performs the following functions

1) As a bank for the governments — As a banker, Central bank performs banking function for government as a commercial bank performs for public by accepting the government deposits & granting loans to the govt. Central bank also performs function of making receipts & collection of payments to C & S Govts & making payments on behalf of C & S Govts.

2) As an agent to government — As an agent central bank manages the public debt, undertakes the payment of interest on this debts & provides all other services related to debt.

3) An advisor to the government — As an advisor central bank gives advice to government regarding economic policy matters money market, capital market etc. It formulates monetary & fiscal policies to regulate supply of money.

2) Explain the Lenders of last Resort function in Central Bank.

Ans When commercial bank faces financial crisis & fails to obtain fund from other sources then central Bank provides them credit. This role of Lenders last Resort saves banks from bankruptcy. Thus plays role of guarantor & maintains sound & health banking system.

Date : ___/___/___

3) Explain Central Bank's function as a currency Authority?

Ans Central bank is given sole monopoly of issuing currency in order to secure control over volume & credit. These notes are circulate throughout country as Legal Tender money. It has to keep a reserve in form of gold & foreign securities as per statutory rules against the notes issued by it. It may be noted that RBI issues all currency in India except 1 rupee. Again under directions of RBI all 1 rupee & small coins are issued by government mints. The Central government of country is usually authorized to borrow money from CB.

4) Calculate the total deposit created by commercial banks if reserve ratio is 10% & Primary deposit is 1250 crores

Ans Primary Deposit — 1250 crores

CRR — 10%.

Total Deposit — 1/CRR × Primary Deposit

= 1/10 × 1250

= 10 × 1250

= 12500 crores.

5) If total deposits created by commercial banks is ₹ 20,000 crores & primary deposit is ₹ 2500 crores, what is valued MM & RR.

Ans CRR = Primary Deposit / Total Deposit × 100

2500/20,000 × 100 = 12.5

Multiplier = 1/CRR = 100/12.5 = 8 times

Date : ___/___/___

6) Explain the distinction between Statutory Liquid Ratio & Legal reserve ratio.

Ans Difference between SLR & CRR are :-

1) Both CRR & SLR are instruments in hands of RBI to regulate money supply in hands of bank that can pump in economy

2) CRR is cash reserve ratio that stipulates percentage of money or cash that Banks are required to keep with RBI

3) SLR is Statutory Liquid Ratio & specifies percentage of money a bank has to maintain in form of cash, gold & other approved securities.

4) CRR controls liquidity in economy while SLR regulates credit growth in country.

5) While banks themselves maintain SLR in liquid form, CRR is RBI maintained as Cash.

7) If Legal Reserve Ratio is 0.2 and new deposits are ₹ 1000 explain the process of money creation by commercial bank.

Ans Legal reserve ratio is requirement of cash reserves which a commercial banks is obliged to maintain

Cash Reserve = Reserve requirement × Bank Deposits

₹ 200 (0.2 × 1000)

Date : ___/___/___

Long Answer Questions

1) Explain the process of Money creation by commercial banks

Ans Commercial banks plays an important role of money creator Suppose a Depositor deposit ₹ 10,000 in his saving account of bank XYZ which will become the demand deposits of bank. All customers will not turn up in same day to withdraw their deposits. bank maintains a minimum cash reserve of 10% of Demand Deposits. ₹ 10,000 it lend remaining 9000 in form of credit to other customer This further creates deposits for the bank XYZ. With cash reserve of ₹ 10000. The credit creation is worth 10,000

Money Multiplier = $\frac{1}{10\%} = 10$

Numerical

Credit creation = Initial Deposit $\times \frac{1}{LRR} = \frac{10,000}{0.1} = 1,00,000$

Money multiplier = $\frac{1}{LRR}$ so Money multiplier = $\frac{1}{0.1}$ = 10 Times.

2) Disuss Difference between Central bank & commercial bank

	Central Bank.	Commercial Bank
1)	Apex body that regulate operate & directs entire banking, & monetary Structure of Country,	Commercial bank is to institution which perform activities like Loan, Accepting Deposits
2)	It operates in public interest	It aims to maximize profit
3)	It has sole monopoly in issue of currency	No power to issue a currency

Date : ___/___/___

4)	It deals directly with public	It not deals directly with public
5)	Owned by government	Owned by govt or private sector
6)	Only one in all world	There are many comm banks.

3) Briefly Discuss following functions of central bank.

1) Currency Authority — It has sole Authority for issue currency in India. In India RBI has sole right to issue paper currency notes, except 1 rupee note, which are issued by finance minister. All currency issued by Central bank is its monetary liability. Central Bank is obliged to back currency with assets of equal value. Central govt is also authorised to borrow money from Central Bank.

2) As A Banker To the Government —
Ans It carries out all banking Activities of government :-
1) It maintains Current Account
2) Accept receipt & Make payment for government
3) Gives Loans & Advances to government

3) Banker's Banks Supervisor -
It There should be a agency to regulate & supervise proper functi
RBI acts as a banker to other banks

1) Custodian of Cash Reserves. — Commercial banks are required to keep a certain proportion of their Deposits with central Banks In this way it acts as a custodian.

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Lender of Last Resort - Help commercial bank by Lending can when banks fail to meet financial requirement & approach to Bankruptcy.

Clearing House :- As central bank holds cash reserves of all commercial banks. It becomes easier & more convinient to act as clearing house. Central bank can easily settle claims of various commercial banks against each other by making debit & credit entries in their account.

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Chapter-7
Aggregate Demand & Related concepts.

1) Calculate APC & APS from following schedule

Income	100	200	300
Consumption	80	120	150

Ans APC = Consumption / Income
APS = Saving / Income

Income	100	200	300
Consumption	-80	-120	-150
Saving	20	80	150
APC	0·8	0·6	0·5
APS	0·2	0·4	0·7

2) At a income level of 5000 crores, total saving is ₹1000 crore. Calculate APC.

Ans Income - 5000 crores
Saving - 1000 crores
Consumption - 4000 crores
APC = 4000/5000 = 4/5 = 0·8

3) Calculate MPC & MPS from following schedule

Income Y.	100	200	300	400	500
Consumption C	85	160	235	310	400
Savings	15	40	65	90	100

Ans MPC — 7·5 7·5 7·5 9
— 2·5 2·5 2·5 1

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4) If households save ₹500 crores out of an additional income of 5000 crores then calculate MPC.

Ans MPC –

Income increased = ₹5000 crores

Saving out of increased amount = ₹500 crore

Consumption increased of additional Income = 5000 − 500 = ₹4500 crores

MPC = Increase in consumption / Increase in income

MPC = 4500/5000 MPC = 9/10 ⇒ MPC = 0.9

5) If the total income increases from 5000 crores to 6000 crores & Savings increases from ₹1000 crores to ₹1500 crores. Calculate MPC.

Ans Change in Income = ₹1000 crores & change in savings = ₹500 crores

Change in consumption = 1000 − 500 = ₹500 crores

MPC = change in Consumption / change in income = 500/1000 = 0.5

6) If MPS is 0.3 and the income increases from ₹6000 crores to 9000 crores, what will be additional consumption in the economy?

Ans Change in Income = ₹3000 crores

MPS = 0.3

Change in savings = 3000 × 0.3 = ₹900 crores

Change in consumption = 3000 − 900 = 2100 crores

7) From the following schedule, compute APC, MPC, MPS

Income	200	200	300	350	400
Saving	–	5	15	20	50
Consumption	200	245	285	330	350
APC	1	0.98	0.95	0.94	0.87
APS	0	0.02	0.05	0.057	0.125
MPC	–	0.9	0.8	0.9	0.4
MPS	–	0.1	0.2	0.1	0.6

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8 Complete the table

Income	Consumption	MPS	APC
0	15	—	—
50	50	0·30	1·00
100	85	0·30	0·85
150	120	0·30	0·80

9) Complete the following table

Income	MPC	Saving	APC
0	—	-30	—
100	0·75	-5	1·05
200	0·75	20	0·9
300	0·75	45	0·85

10) Complete the following table :-

Income	Saving	MPC	APC
0	-20	~~0·50~~	—
50	-10	0·80	1·20
100	0	0·80	1
150	30	0·40	0·80
200	60	0·40	0·70

11) If National income is ₹50 crore & saving ₹5 crore, find out average propensity to consume. When income rises to ₹60 crore & saving ₹9 crore what will be the APC & MPS

Ans $Y = 50$ crore

$S = 5$ crore

$APC = C/Y = 45/50 = 0.90$

Case 2

$Y = 60$ crore $S = 9$ crore

$APC = C/Y = 60-9/60 = 0.85$

$\Delta S = 9-5 = 4$ crore

$\Delta Y = 60-50 = 10$ crore

$MPS = \Delta S/\Delta Y = 4/10 = 0.40$

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12) Using the consumption function $C = \bar{C} + b(Y)$ calculate saving at income of ₹ 2000 crores if Autonomous consumption is ₹ 150 crores & 40% of additional income is consumed.

Ans At income level ₹ 2000 crores

Consumption = $150 + 0.4 \times 2000$

$= 150 + 800 = 950$ crore

Savings = Income − Consumption = $2000 - 950 = ₹ 1050$ crores

13) The saving function is given as $S = -120 + 0.4(Y)$ Determine
i) Consumption function ii) Consumption at income level of ₹ 600 crores
iii) Break-even level of income

i) $S = -120 + 0.4Y$ $C + S = Y \Rightarrow C = Y - S = Y - (-120 + 0.4Y)$
$= Y + 120 - 0.4Y = 120 + 0.6Y$ Hence $C = 120 + 0.6Y$

ii) At income level 600 crores $C = 120 + 0.6(600) = 120 + 360 = 480$ crore

iii) Break even point refers to the point where the income = Consumption or savings = 0. Therefore, $Y = C$

$\Rightarrow Y = 120 + 0.6Y$

$Y = 0.6Y = 120$

$0.4Y = 120$

$Y = 120/4 = 300$ crores

14) The consumption function for an economy is given as $C = 200 + 0.8Y$
i) Determine the value MPC & MPS
ii) Autonomous Consumption
iii) Derive the corresponding saving function
iv) Calculate consumption at income level of ₹ 3000 crores & 5000 crores
v) Determine break-even level of income

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Ans 1) i) MPC refers to percentage change in consumption for every one rupee of change in the income. It is ratio b/w the change in income & corresponding change in consumption MPC = 0.8

ii) MPS refers to percentage change in saving for every 1 rupee of change in income. It is ratio b/w the change in income & corresponding change in savings
MPS = 1 − MPC = 1 − 0.8 = 0.2

ii) Autonomous consumption refers to that consumption which occurs where there is no income in economy. It is minimum level of consumption that takes place in economy. So if income is 0; then
C = 200 + 0.8 + 0 = 200 crores

iii) Savings function refers to standard equation of saving which defines the relationship b/w savings & income where saving values can be derived at each level with use of income value.
S = S + Y(1−b) where S = autonomous saving (1−b) = MPS Y = income
Savings = Y − C
S = Y − (200 + 0.8Y)
S = Y − 200 − 0.8Y
S = 200 + Y(1 − 0.8)
S = −200 + 0.2Y
Saving function is S = −200 + 0.2Y

iv) At income level 3000 crores
C = 200 + 0.8(3000)
200 + 2400 = 2600 crore

v) Break even point refers to the point where the income = consumption or Savings = 0 Therefore Y = C
Y = 200 + 0.8Y ⇒ Y − 0.8Y = 200 ⇒ 0.2Y = 200
Y = 200/0.2 = 1000 crores

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15) If MPC is 4 times MPS & consumption at 0 level is 70 crores derive consumption function?

Ans 4 MPS + MPS = 1

5 MPS = 1

MPS = 1/5 = 0.2

MPC = 0.8

∴ Autonomous C = 70

∴ C = c + by

C = 70 + 0.8y

16) The consumption curve makes an intercept of ₹ 60 crores on Y axis If MPC : MPS can be expressed as 1 : 3, then derive the saving & consumption function. Also determine level of income when saving become 0:

Ans C = c̄ + by c̄ = 60 crores MPC : MPS = 1 : 3

Let suppose MPC = x — ①

MPS = 3x — ②

MPC + MPS = 1 — ③

Put the value of MPC & MPS in eq ③

x + 3x = 1 x = 1/4 = 0.25

4x = 1

MPS = 1 − MPC C = 60 + 0.25y

= 1 − 0.25 = 0.75

S = −c̄ + (1 − b)y = −60 + 0.75y

S = 0, Y = C (Break even level of Y)

C = c̄ + by

Y = c̄ + by

Y = 60 + 0.25y

Y − 0.25y = 60

0.75y = 60

y = 60/0.75 = 60 × 100/75 = 80 crores

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(7) The break even point for an economy occurs at a time income level of 500 crores. If MPC = 0.6 i) Autonomous consumption ii) Saving function iii) Level of income when savings is 600 crores.

Ans $C = \bar{C} + b(Y)$ $Y = C$

$Y = \bar{C} + bY$

$500 = \bar{C} + 0.6(500)$

$500 = \bar{C} + \frac{6}{10} \times 500$

$500 = \bar{C} + 300$

$\bar{C} = 200$ crores

MPC = 0.6

MPS = 0.4

Saving function $= -\bar{C} + (1-b)Y$

$= -200 + 0.4(Y)$

iii) $600 = -200 + 0.4Y$

$600 + 200 = 0.4Y$

$800 = 0.4Y$

$Y = \frac{800}{0.4} = 2000$ crores

(8) The consumption function of an economy is given as $C = 40 + 0.7Y$. Calculate the saving at income level of 2200 crores.

Ans $C = 40 + 0.7 \times 2200$

$= 40 + 1540 = ₹1580$ crores

Savings = Income − Consumption $= 2200 - 1580 = ₹580$ crores

(9) The saving curve makes an intercept of ₹40 crores on negative Y axis. If consumers spend 60% of additional income, then determine : i) Saving function ii) Consumption function iii) Break even level of income.

Ans $S = -\bar{S} + Y(1-b)$

Autonomous savings = 40 crores

Consumer spends 60% they save 40%.

MPS = 0.4

$S = -40 + 0.4Y$ where 40 crores = Auto savings, 0.4 = MPS, Y = Income

i) $C = \bar{C} + bY$

$S = -40 + 0.4Y$

$C + S = Y - S$

$Y = (-40 + 0.4Y)$

$Y + 40 + 0.4Y$

$= 40 + 0.6Y$

$\therefore C = 40 + 0.6Y$

c) $Y = C$

$Y = 40 + 0.6Y$

$Y - 0.6Y = 40$

$0.4Y = 40$ $Y = 40/0.4 = 100$ crores

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20) If national income is 90 crores & Consumption expenditure 81 crores find APS when income rises to ₹100 crores & Consumption exp = 88 crores. What will be MPC, MPS?

Ans Here in 1st condition

$Y = 90$ crore

$C = 81$ crore

$APS = S/Y = Y-C/Y = 90-81/90 = 0.10$

When Income & Consumption exp rises

$Y = 100$ crore $C = ₹88$ crore

$\Delta C = 88-81$ ₹7 crore $\Delta Y = 100-90 = ₹10$ crore

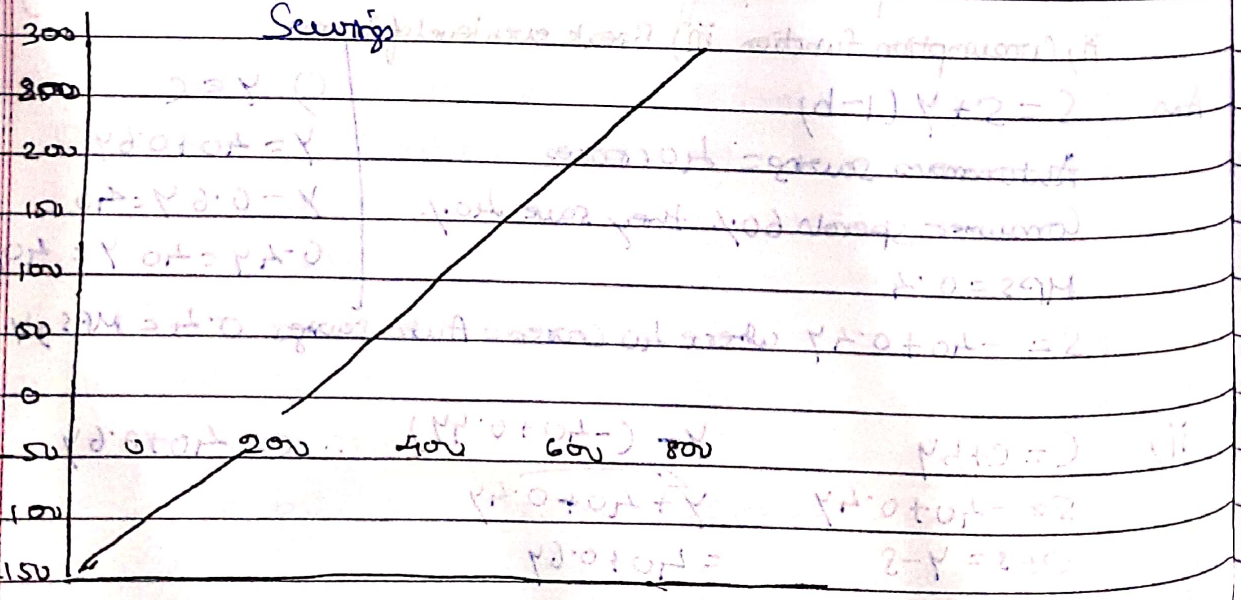
$MPC = \Delta C/\Delta Y = 7/10 = 0.70$

$MPS = 1-MPC = 1-0.7 = 0.30$

21) The saving function is given as $S = -120 + 0.5Y$. Draw a diagram showing savings corresponding to income levels of 0, 200, 400, 600 & 800.

Ans

Income Y	Savings $(-120+0.5Y)$
0	−120
200	−20
400	80
600	180
800	280



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22) If consumption function is given by, $C = 30 + 0.4Y$, then determine (i) Savings at zero level of income (ii) MPC (iii) MPS (iv) Break even level of income (v) Saving Function

Ans $C = 30 + 0.4Y$

i) $-\bar{C} = -30$

ii) $MPC = 0.4$

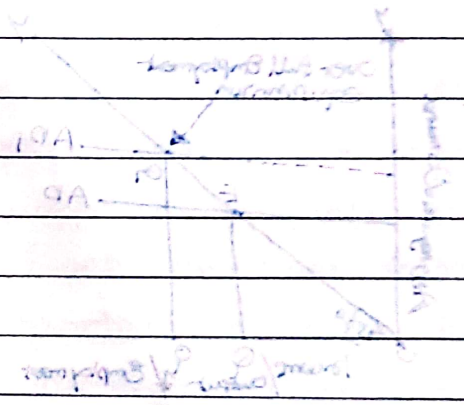
iii) $MPS = 1 - MPC = 0.6$

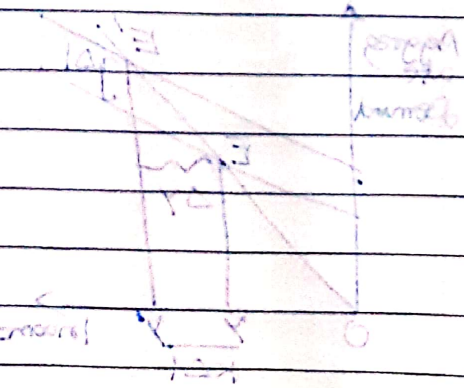
iv) $Y = C \quad Y = 30 + 0.4Y \quad (Y - 0.4Y) = 30 \quad 0.6Y = 30$

$Y = \frac{30}{6} \times 10 = 50$ Break even level

v) $S = -\bar{C} + (1-b)Y$

$= -30 + 0.6Y$





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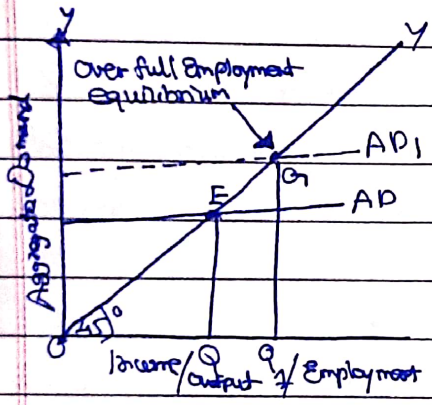
Chapter - 8
Income Determination & Multiplier.

1) Can an economy be in equilibrium when there is unemployment in economy

Ans As long as the demand = the supply the economy will be in equilibrium. If the demand is met by employees less no of people than the no of people willing to work then of course the economy is at equilibrium with unemployment still present in it.

2) Briefly discuss the concept of over full employment equilibrium with diagram.

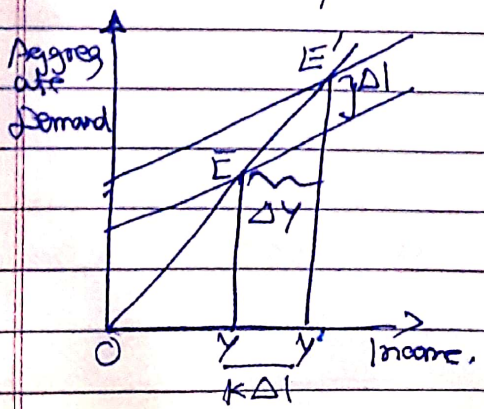
Ans It refers to a situation when AD is equal to AS beyond full employment level.



3) Discuss the concept of multiplier with help of diagram

Ans Investment multiplier refers to the no of time by which increase in output or income exceeds the increase in investment. It is measured as the ratio between change in income & change in investment & it is denoted as K

K = change in income / change in investment



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Explain meaning of Under employment equilibrium?

Ans It refers to a situation when the aggregate demand is equal to the aggregate supply when the resources are not fully employed.

Long Answer Questions

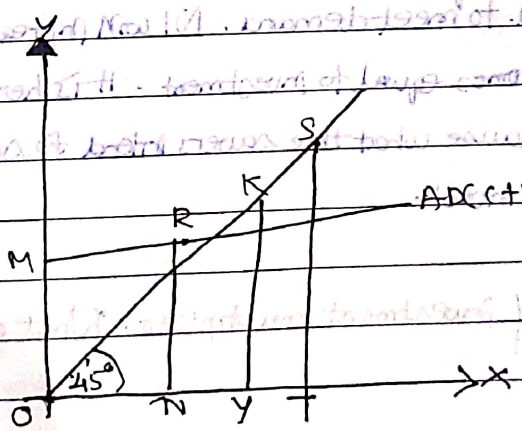
Explain determination of equilibrium level of income using Consumption plus investment approach. Use diagram.

OR

Explain with the help of a diagram, how equilibrium level of income is determined considering aggregate demand & aggregate supply

Ans The equilibrium is determined only when AD equals AS because at this level there is no tendency for income & output to change.

In this diagram equilibrium is at K where AD intersect 45 line. At this point AD = AS When AD is more than AS then planned inventory would fall below desired level. To bring back the inventory at desired level the producers expand output. More output means more income. Rise in output means rise in AS & rise in income means rise in AD. Both continue to rise till reach K where AD = AS When AD is less than AS then the planned inventory rises above the desired level. To clean the unwanted increase in inventory, firms plan to reduce the output till AD becomes equal to AS. Equilibrium takes place only at point K when AD = AS



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2) In an economy planned saving exceeds planned investment. How will the equality between the two be achieved? Explain.

Ans If in an economy planned saving exceeds planned investment, that would result in undesired build up of unsold stock. Consequently AD falls short of AS. Due to excess supply resulting from stock piling of unsold goods i.e. unintended inventories, producers will cut down employment & will produce less. National income will fall as a result planned saving will start falling till it becomes equal to planned investment. It is at this point that equilibrium level of income is determined.

3) What changes will take place to bring an economy in equilibrium if.

i) Planned savings are greater than planned investment.

ii) Planned savings are less than planned investment.

Ans i) In an economy if planned saving exceeds planned investment, then that would result in undesired build up of unsold stock. Consequently AD falls short of AS. Due to excess supply resulting from the stock piling of unsold goods i.e unintended inventories, the producers will cut down employment & will produce less. NI will fall & as a result planned saving will start falling until it become equal to planned investment. It is at point of equilibrium level of income is determined. On other hand if.

ii) Planned savings fall short of planned inv then AD is more than AS. Production will have to be increased to meet demand. NI will increase leading to rise in saving until saving becomes equal to investment. It is here equilibrium level of income is established because what the savers intend to save becomes equal to what investors intend to invest.

4) Discuss the meaning of investment multiplier. What can be its minimum & maximum value?

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Ans When investment expenditure increases there is multiple increase in income. The ratio of increase in income to increase in investment expenditure are valued multiplier. Its value equals.

5) Explain the working of investment multiplier with help of numerical example.

Ans Investment multiplier refers to increase in National income as a multiple of a given increase in investment. Its value is determined by MPC

$$\frac{1}{1-MPC} \text{ or } \frac{1}{MPS}$$

Suppose increase in investment is ₹1000 & MPC = 0.8 Increase in national income is in following sequence. Increase in investment raises income of those who supply investment goods by ₹1000

Since MPC = 0.8, the income earners spend ₹800 on consumption. This raises income of suppliers of consumption goods by 800.

$\Delta Y = \Delta I \times \frac{1}{1-MPC}$

$\Delta Y = 1000 \times \frac{1}{1-0.8} = ₹5000$

Unsolved Practicals

1) Calculate the value of multiplier if entire increase in income is saved.

Ans Multiplier – K

$\Delta Y = \underset{0}{\Delta C} + \Delta S$ $\quad K = \frac{1}{MPS}$

$\Delta Y = \Delta S$ } given $\quad K = \frac{1}{1}$

Saving $\xleftarrow{MPS}$ Income $\quad \therefore \boxed{K = 1}$

$MPS = \frac{\Delta S}{\Delta Y}$

$MPS = \frac{\Delta Y}{\Delta Y} = 1$

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2) In an economy investment increases by 200 crores. As a result, total income increase by 1000 crore. Calculate the MPC.

Ans $\Delta I = 200$ crore, $\Delta Y = 1000$ crore } Given

$MPC \rightarrow \frac{\Delta C}{\Delta Y}$

$\frac{\Delta Y}{\Delta I} = \frac{1000}{200} = 5 \Rightarrow K =$ Investment multiplier

$K = \frac{1}{1-MPC}$

$5 = \frac{1}{1-MPC}$

$1-MPC = \frac{1}{5}$

$1-\frac{1}{5} = MPC$

$\frac{4}{5} = MPC$

$\therefore MPC = 0.8$

3) Calculate MPC & Multiplier from the following data

Income	100	200	300
Consumption	80	160	250
MPC	—	0.80	0.90
Multiplier	—	5	10

4) In an economy the investment expenditure is increased by 2000 crores. Calculate the total increase in income & consumption expenditure if ratio of MPC & MPS is 4:1

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Ans MPC/MPS = Δ/1

MPC = Δ1 MPS

We know

MPC + MPS = 1

Δ1 MPS + MPS = 1

5 MPS = 1

MPS = 1/5 = 0.2

K = Change in Income / Change in Investment = 1/1−MPC

Change in Income / 2000 = 1/0.2

Change in Income / 2000 = 5

Change in Income = 5 × 2000 = 10,000 crores

Increase in income = MPC * Y = 0.8 × 10,000 = 8000 crores

5) In an economy with every increase in income, 70 percent of increased income is spent on consumption. Suppose a fresh investment of 300 crores takes place in the economy. Calculate the following i) Change in Income (ii) Change in saving

Ans i) $K = \frac{1}{1-MPC} = \frac{1}{1-\frac{70}{100}} = \frac{1}{\frac{30}{100}} = 1 \times \frac{100}{30} = 0.3$

$k = \frac{\Delta Y}{\Delta I}$ or $0.3 = \frac{\Delta Y}{300}$

$\Delta Y = 0.3 \times 300 = 90$ crores

(ii) ΔI = 300 crores

MPC = 0.7

MPC + MPS = 1

0.7 + MPS = 1

MPS = 1 − 0.7 = 0.3

$K = \frac{1}{MPS}$ $K = \frac{10}{0.3} = 3.33$

$K = \frac{\Delta Y}{\Delta I}$ $3.33 = \frac{\Delta Y}{300}$

ΔY = 300 × 3.33

= 999.99

ΔY = 1000 crores

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(5) ΔS =

$MPS = \frac{\Delta S}{\Delta Y}$

$\frac{0.3}{0} = \frac{\Delta S}{1000 \text{ crores}}$

$\Delta S = 300$ crores

~~6) If consumption at 0 level of income is 20 crores & investment multiplier is 2 then determine relevant consumption function~~

6) It is planned to increase national income by 1000 crores, how much increase in investment is required to achieve this goal, Assume MPS 0.4 calculate.

Ans $K = \frac{\text{change in Income}}{100} = \frac{1}{MPS}$

$\frac{\text{change in Income}}{1000} = \frac{1}{0.4}$

$\frac{\Delta Y}{1000} = 2.5$

$\Delta Y = 2.5 \times 1000 = 2500$ crores

7) Calculate AD, AS for every level of income & the equilibrium level from following schedule if investment fixed at 40 crore

Income	100	200	300	400	500	600
Consumption	120	200	280	360	440	520

Ans

Income	Consumption	Saving	Investment	C+I AD	AS=I
100	120	-20	40	160	100
200	200	0	40	240	200
300	280	20	40	320	300
400	360	40	40	400	400
500	440	60	40	480	500
600	520	80	40	560	600

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8) The saving function of economy is given as $S = -50 + 0.4Y$. The economy is in equilibrium at income level of ₹1500 crores. Calculate (a) Investment at equilibrium income level, b) Autonomous consumption (c) Multiplier.

Ans $S = -50 + 0.4Y$

$Y = 1500$ crores

(a) $S = -50 + 0.4Y$

$S = -50 + 0.4(1500)$

$S = -50 + 600$

$S = 550$ crores

$S = \bar{S} + (1-b)Y$

$\frac{\Delta S}{\Delta Y}$

$(1-b) = 0.4$

$MPS = 0.4$

$MPC = 0.6$

~~by MPS + MPC = 1~~

$I = ?$ At eqn $\rightarrow S = I$ $AD = AS$, $C+I = C+S$, $I = S$

$I = 550$ crores

b) $\bar{C}$ → consumption at 0 level of income

$C = \bar{C} + b(Y)$ → consumption function

$AD = C+I$

$1500 = C + 550$

$C = 950$

$950 = \bar{C} + 0.6(1500)$

$950 - (0.6 \times 1500) = \bar{C}$

$950 - 900 = \bar{C}$

$\boxed{\bar{C} = 50}$ Ans.

c) $K = \frac{1}{MPS}$ or $\frac{1}{1-MPC}$

$YK = \frac{10}{0.4}$

$K = 2.5$

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9) In an economy consumption function is $C = 600 + 0.9Y$ where C is consumption exp & Y is income. Calculate the equilibrium level of income & consumption when investment expenditure is 500.

Ans $C = 600 + 0.9Y$, $I = 500$

$Y = C + I$

$Y = 600 + 0.9Y + 500$

$Y - 0.9Y = 1100$

$0.1Y = 1100$

$Y = \frac{1100}{0.1} = \boxed{11000}$

b) $C = 600 + 0.9Y$

$600 + 0.9(11000)$

$C = 600 + 9900$

$C = 10,500$

10) In an economy $C = 300 + 0.8Y$ & $I = 500$ where C is consumption, Y is income, I = Investment, Calculate the following (a) Equilibrium level of income. (b) Consumption expenditure at equilibrium level of income

Ans $C = 300 + 0.8Y$, $I = 500$

a) At Equilibrium $Y = C + I$

$Y = 300 + 0.8Y + 500$

$Y - 0.8Y = 800$

$0.2Y = 800$

$Y = \frac{800}{0.2}$

$\boxed{Y = 4000}$ Equilibrium level of income

b) $C = 300 + 0.8Y$

$C = 300 + 0.8(4000)$

$C = 300 + 3200$

$C = 3500$

Date : __/__/__

11) From the following information about an economy, calculate its i) Equilibrium level of national income. ii) Saving at equilibrium level of national income. Consumption function: $C = 200 + 0.9Y$ Where C is consumption, Y = national income Investment Expenditure I = 3000

Ans $C = 200 + 0.9Y$

$I = 3000$

i) Y, At equilibrium level $= C + I$

$Y = 200 + 0.9Y + 3000$

$Y - 0.9(3200)$

$0.1Y = 3200$

$Y = \frac{3200}{0.1} = \boxed{32000}$

ii) Saving at Y

$C = 200 + 0.9Y$

$C = 200 + 0.9(32000)$

$C = 200 + 28800$

$C = 30,000$

$Y = C + S$

$32000 = 30,000 + S$

$S = 2000$

Date : ___/___/___

Chapter-9
Excess Demand & Deficient Demand

Short Answer Type Questions

1) What are the reasons for excess Demand

Ans) Main reason for Excess Demand are :-

1) Increase in household consumption
2) Increase in government expenditure
3) Increase in money supply
4) Increase in Public Investment demand

2) What are impacts or effects of excess demand on price, output & employment

Ans 1) Effect on General Price Level - Excess demand rises general price level because it arises when AD is > than AS at full employment level.

2) Effect on Output - E:D has no effect on the level of output.

3) Effect on Employment - There will be no change in employment also

3) What are the reasons causes of Deficient Demand ?

Ans Main causes of Deficient Demand are :-

1) Decrease in Household consumption
2) Decrease in export Demand
3) Decrease in money supply
4) Decrease in government expenditure.

4) What are impacts or effects of deficient demand on price output & employment.

Ans Effect on General Price Level - Deficit demand cause general price level to fall because it arises when aggregate Demand is less than aggregate Supply at full employment level. There is deflation in economy known as Deflationary gap.

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2) Effect on Employment - Due to deficient demand investment level is reduced which causes involuntary unemployment in economy due to fall in g.n.e.d output

3) Effect on output - Low level of investment & employment implies low level of output.

5) Explain role of Government expenditure & Open market operations in reducing AD / excess demand

(a) Government expenditure

1) Government has to invest huge amount on public works like roads, buildings Irrigation works

2) During inflation govt should curtail its expenditure on public works like roads, buildings irrigation works thereby reducing the money income of people & demand for goods & services

b) Open Market operation

1) It consists of buying & selling of government securities & bonds in the open market by central bank.

2) In a situation of excess demand leading to inflation, central bank sells govt securities & bonds to commercial bank with the sale of those securities, power of commercial banks of giving loans decreases which will control demand.

6) Differentiate between full employment & Under employment equilibrium

Full employment Equilibrium	Under Employment Equilibrium
Full employment equilibrium refers to the situation where AD is equal to AS & all those who are able to work & willing to work at existing wage rate are getting work.	Under employment equilibrium refers to the situation where AD is equal to AS but all those who are able to work willing to work at existing wage are not getting work.
2) Full employment equilibrium is a stable equilibrium & real output reaches maximum point	Underemployment equilibrium is not stable & real output does not reach maximum point.

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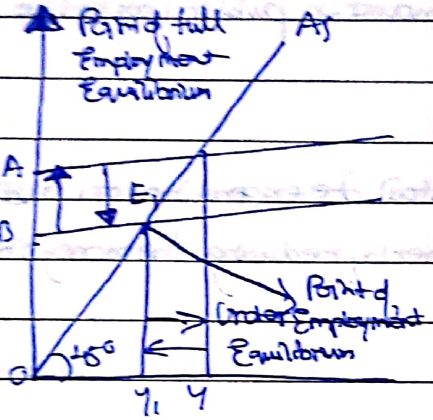
Long Answer Type Questions

2) Explain concept of underemployment with help of diagram. Show same diagram additional investment exp required to reach full employment equilibrium. Or Explain meaning of Underemployment equilibrium. Explain 2 measures by which full employment can be reached.

Ans Underemployment equilibrium refers to a situation when equilibrium is attained aggregate demand is equal to aggregate supply below full employment level or when resources are not fully employed



Aggregate demand shift downward from AD to AD1 Equilibrium at level which is full employment level.

AD shift downward because of following

1) Decrease in household consumption
2) Decrease in Private Investment
3) Decrease in Export Demand
4) Decrease in money supply

3) In order to achieve full employment equilibrium deficiency of demand must be corrected through additional investment expenditure.

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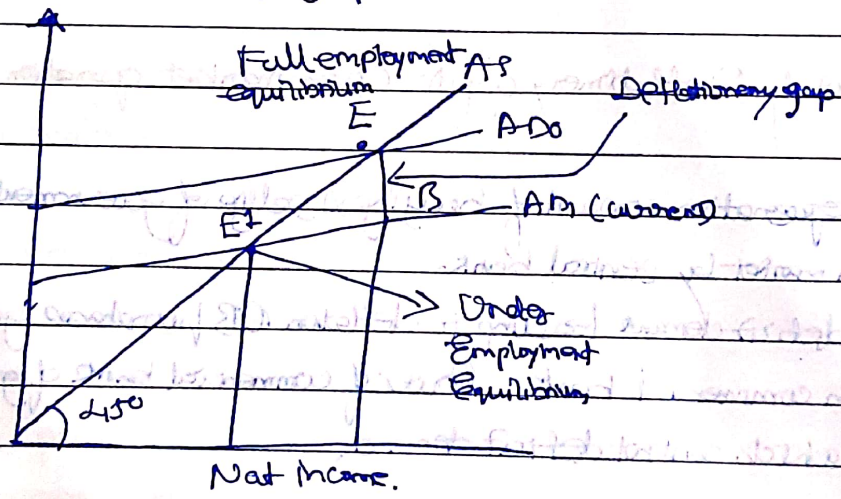
2) Differentiate between Inflationary gap & deflationary gap.

Ans

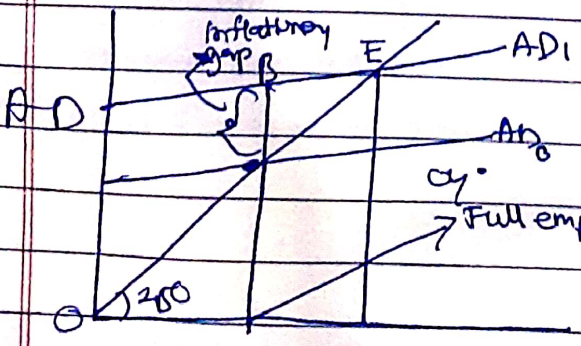
	Inflationary gap	Deflationary Gap
1)	It refers to gap which actual AD exceeds AS at level of full employment	It refers to the gap by which actual AD falls short of AS at level of full employment
2)	It does not affect output & employment	It leads to fall in output & employment
3)	It leads to Inflation	It leads to deflation

Yes deflationary gap can exist at equilibrium level of income.



3) Explain the concept of Inflationary gap. Explain role of repo rate in reducing gap.

Ans Inflationary gap is gap showing excess Actual AD over AS at level of full-employment.



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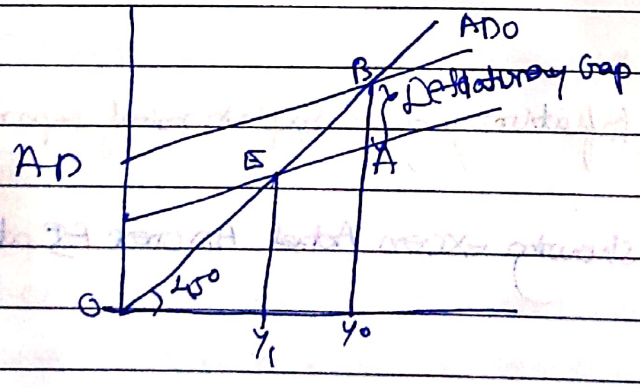
3) Repo rate - Rate at which commercial bank borrow money from RBI
In situation of inflation
1) Central bank raises repo rait
↓
Discourage borrowing
↓
Increase cost of borrowing
↓
Increase lending rates
↓
Discourage borrowers to take loan

4) Explain concept of Deflationary gap in Open market operations in reducing gap.

Ans) Open market operation consist of buying & selling of government securities & bonds in open market by central bank.
In situation of deficit demand leading to deflation CB purchases govt securities & bonds from commercial bank. Power of commercial bank of giving loan increases which control deficit demand.



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Chapter-11
Foreign Exchange Rate

1) Give two reasons for rise in demand for a foreign currency when its price falls?

Ans The demand for foreign currency rises in following situations :-

1) When price of foreign currency falls imports from that, foreign country becomes cheaper. So, imports increases & hence demand for foreign currency rises

2) When a foreign currency becomes cheaper in terms of domestic currency it promotes tourism to that country, as result demand of foreign currency rises.

3) When price of foreign currency falls ⇒ demand rises as more people want to make gains from speculative activities.

2) Give 3 sources each of demand & supply of foreign exchange.

Ans Following factors cause demand for foreign exchange ie foreign exchange is demanded by domestic residents for following reason.

1) To purchase good & services from foreign countries
2) To purchase financial asset in foreign country.
3) To speculate on value of foreign currencies
4) To send gift Abroad.

Supply of foreign Exchange comes from

1) Domestic exporters who receive payment of foreign currency
2) The foreigners who invest & lend in home country
3) Domestic resident who repatriate capital fund previously sent abroad
4) Direct Purchase by non resident in Domestic market

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3) Explain how depreciation of currency promotes export of country?

Ans Depreciation of your currency would mean foreigners need to pay more lesser amount to their currency to buy the goods your country exports. ie the foreign price of your exports decreases & their demand increases.

4) Write short notes on 1) Spot market 2) Forward market

Ans Spot rate of exchange of current rate of exchange is that rate which happens to prevail at time when transaction are injured. Spot market is of daily nature it does not trade in future deliveries.

Forward market for foreign exchange is that market which handles such transactions of foreign exchange that are meant for future delivery. Such transactions are signed today but are to be honored on some future date.

5) When price of foreign currency rises, it supply also rises. Explain why?

Ans Supply of foreign currency rise due to following situation

1) When price of foreign currency rises domestic goods become relatively cheaper. It induces foreign country to increase their imports from domestic country. As a result supply of foreign currency rises.

2) When price of foreign currency rises FDI from rest of world increases which will increase supply for foreign exchange.

3) When price of a foreign currency rises, also supply of foreign currency rises as people want to make gains from speculative activities.

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6) Why are foreign exchange rate & demand for foreign exchange inversly related explain?

Ans When foreign exchange rate rises, imports become costly for the domestic customer. This reduces demand for imports causing fall in demands for foreign exchange. When foreign exchange rate falls, opposite happens. Import becomes cheaper & in turn raising demand for foreign exchange.

When Price of foreign currency falls, its demand rises, owing to following

1) Indian Players in int markets will buy more of foreign currency because now it is available at a lower price. Thus demand rises.

2) Now imports become cheaper than before. Accordingly imports tend to rise implying a rise in the demand for foreign currency.

3) Travelling abroad now becomes cheaper. Accordingly demand for foreign currency rises.

7) Appreciation & Revaluation of currency are one & same thing. Do you Agree? Comment.

Ans False, Revaluation refers to increase in value of domestic currency by the government under fixed exchange rate. On the other hand, currency appreciation refers to increase in value of domestic currency in terms of foreign currency under flexible exchange rate system.

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Long Answer Type Questions

1) Distinguish between the fixed exchange rate & floating exchange rate. If exchange rate falls its effect effect on import & export.

Ans Fixed rate of exchange refers to rate of exchange as fixed by the government. Historically it has 2 variants, Gold standard System of exchange rate & Bretton wood system of exchange rate. Flexible or floating rate of exchange is the rate which is determined by the supply demand forces in foreign exchange market. It is also called free exchange rate as it is determined by the free play of supply & demand forces in the international money market. When exchange rate falls import rise since import is a component of demand of foreign exchange & exports fall as export is component of supply of foreign Exchange.

2) Explain by giving example distinction between depreciation & devaluation of value.

Ans Devaluation is the decrease in value of domestic currency corresponding to foreign currency as planned by Central bank in case when exchange rate is not determined by demand & supply forces but is fixed by the govt of various nations. Depreciation is decrease in value of domestic currency corresponding to foreign currency, in a case when exchange rate is determined by forces of supply & demand in international money market. Both depreciation & devaluation will result in value of domestic currency in terms of foreign currency However devaluation causes desired fall in value of rupee which in turn boost the exports. The depreciation causes undesired fall in value of rupees where the import bill of govt may become too high leading to a rise in fiscal deficit to unmanagable limit.

3) What is foreign Exchange market. Discuss major functions performed by foreign Exchange Market.?

Ans Foreign Exchange market is a market in which foreign currencies are brought & sold.

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Functions of foreign Exchange market :—

1) Transfer functions :— It transfers purchasing power between countries. It takes place in transaction. This function is performed through credit instruments like bill of foreign exchange, bank drafts & telephonic transfers.

2) Credit function :— It provides credit for foreign trade. Bills of exchange, with maturity period of 3 month, are generally used for international payments. Credit is required for this period in order to enable the importer & the person of goods sell them, obtain money to pay off the bill.

3) Hedging function :— When exporters & importers enter into an agreement to sell & buy goods on some future date at current price & exchange rate is called hedging. The purpose of hedging is to avoid losses that might be caused due to exchange rate variations in future.

4) Discuss briefly meaning of
1) Fixed exchange rate
2) Flexible exchange rate
3) Managed floating exchange rate.

Fixed exchange rate :—

It refers to a system in which exchange rate for a currency is fixed by government.

- Basic Purpose — To ensure stability in foreign trade & capital movements.
- To Achieve Stability — Govt buys foreign currency when exchange rate is low & sell it when rate of exchange of foreign currency becomes high.
- Each country keeps value of its currency fixed in terms of External Standard.
- External can be gold or silver & other precious metal
- When value of Domestic currency tied to value of another country is called Pegging.
- When value of currency is fixed in terms of gold it is called Parity.

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Flexible exchange rate - Refers to a system in which exchange rate is determined by the forces of demand & supply of different currencies in foreign exchange market.

- Value of currency is allowed to fluctuate freely according to changes in demand & supply
- No government intervention
- Also known as Floating Exchange Rate.
- Determined by market

Managed floating rate system - Refers to system in which foreign rate is determined by market forces & central bank influences the exchange rate through intervention in foreign exchange market.

1) Hybrid of fixed exchange rate & flexible exchange rate system
2) Known as Dirty floating
3) Central bank maintain reserves of foreign exchange to ensure that ex rate stays with targeted value

Date : ____/____/____

Chapter-12
Balance of Payment

1) What it meant by visible items & invisible item in BOP account. Give example of 2 items?

Ans: Visible items of BOP accounts are those material goods which are seen crossing the boarder. They are recorded at ports. Examples of visible items are 1) Rice 2) Tea 3) Machinery 4) Cloth because they are visible to eyes. Again the balance of export & imports of goods is called balance of visible trade.

Invisible items of BOP - It refers to all type of services banking insurance which are given & received, they cannot be seen touched or measured.

Visible Items:- Includes all type of Physical goods which are exported & imported. They can be seen touched measured.

2) Distinguish between BOT account & balance on current account?

Ans,

BOT	Current Account
1) Balance of trade include only visible items	Current items records both visible & invisible items
2) Narrow concept as it only a part of current account.	It is wider concept & it includes BOT

3) Explain meaning of deficit in Balance of Payment Account?

Ans Deficit in balance of payment account arises when total inflows of account of autonomous transactions are less than outflows on account of such transactions.

4) State the components of capital Account of Balance of Payment

Ans Components of Capital Account are:-

1) Borrowing and Lending to and from abroad.
2) Investments to and from abroad
3) Change in foreign exchange reserves.

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5) Distinguish between current Account & Capital account of BOP account. Is Import of machinery recorded in Capital or current Account?

Ans

Current Account	Capital Account
1) Current Account transactions bring a change in current level of country's income.	Capital transactions bring about a change in the capital stock of a country.
2) It is flow concept as it includes all items of flow nature	It is stocks concept as it includes all items expressing changes in stock.
3) Current Account = Visible trade + Invisible Trade + Unilateral Transfers + Income receipts & payments.	Capital Account = Borrowings & Lendings to and from abroad + Investments to & from abroad + change in foreign exchange reserves

6) India Investors borrow from abroad. Answer the following

(a) In which sub-account & on which side BOP Account will this borrowing be recorded.

(b) Explain what is impact of this borrowing on exchange rate

Ans(i) Borrowings from abroad are recorded in Capital Account of BOP because these give rise to foreign exchange liabilities. These are recorded on credit side because these bring foreign exchange into the country.

(ii) Borrowing from abroad raises supply of foreign exchange. Demand for foreign exchange remaining unexchanged exchange rate is likely to fall.

7) What is meant by official reserve transactions? Discuss their importance in BOP?

Date : ____/____/____

Ans Official reserve transactions are transaction made by Central bank which cause change in its official reserve of foreign exchange. This happens only when a country withdraw from its stock of foreign exchange reserves to finance deficit in its overall BOP.

Long Answer Question

1) What is meant by BOP? What are its components? Explain them briefly.

Ans BOP is an accounting system that provides a systematic records of all economic transactions, b/w residents of country & rest of the world in given time. There are 2 component of BOP

Current Account – Records all transactions related to import & export. component of current Account.

1) Export & Import of goods → Visible Items, Invisible Items

2) Export & Import of services → Shopping, Banking, Insurance

3) Unilateral ⇒ gift, donation, Personal remittance, Pension.

4) Income receipt from Abroad, Interest rent Profit

Capital Account – Records all transaction b/w residents of country & rest of the world.

Components

1) Borrowing or lending from abroad → Borrowing by Pvt sector, Recorded on credit

2) Investment To and from Abroad.

Recorded on credit: Investment by foreign company to India

Recorded in Debit: India Invest to foreign comp

Date : ____/____/____

2) What is 'Capital Account' What are its Components. Explain briefly.

Ans: Capital Acc records all those transaction b/w residents of a country & rest of the world which cause change in asset.

Component of Capital Account

1) Borrowing & Lending from Abroad
   1) All transaction from Abroad by by Private sector (Cr) side.
   2) All Lending transaction to Abroad (Dr) side.

2) Investment to & from Abroad.
   1) Investment by rest of world to Indian company (Cr) side.
   2) Investment by Ind to rest (Dr) side.

3) Change in foreign Reserve.
   1) Withdrawal is recorded on Cr side
   2) Addition is recorded on Dr side.

3) What is Current Account. What are its components ?

Ans Records All transaction related to Import & Export of goods & services & unilateral transfer during given time

Component of Current Account

1) Import & Export of Goods & Services (Exp of Goods → Cr, Pay of Service → Dr / Pay of good → Dr, Exp → Cr)
   - Visible goods: Can be seen, Tea
   - Invisible goods: Cannot be seen
   - Services → banking, Investment, Interest

2) Unilateral transfer to & from Abroad.
   - One sided: Gift, Donation, Pension

3) Income (Reciept & Payment to and from abroad) — Income & Payment in form of Interest, Rent, Profit

Date : ____/____/____

4) Distinguish b/w Current/Capital A BOP A BOT accounts?

Ans. Different b/w Balance of Trade A Balance of Payment

	BOT	BOP
1)	Refers to diff between amount of export A import of visible items.	Provides systematic record of all economic transaction b/w resident of country A rest world.
2)	Only visible items	Visible, Invisible, Unilateral Capital Transfer
3)	Narrow concept	Broad concept
4)	No capital transaction	All transaction of Cap nature.

Difference b/w Current A Capital Accounts?

	Current Account	Capital Account
1)	Brings change in current level of country's income	Brings change in capital stock of a country.
2)	Flow concept	Stock concept
3)	Comp — Visible trade + Invisible trade + Unilateral Income/Receipts A Payment	Comp — Borrowings A lendings to abroad + Inv to A from Abroad + change in Foreign Exchange Reserve.

5) Differentiate between Autonomous Items A Accomodating Items. Explain Deficit in BOP?

Date : ____/____/____

Ans. Difference between Autonomous & Accomodating Items

Autonomous Items	Accomodating Items
1) Refer to International economic transaction which take place due to Profit motive.	1) Refer to transaction that undertaken to cover debit or surplus in Autonomous transactions.
2) Independent in BOP	2) Undertaken to maintain BOP
3) Takes place on both current & Capital Account.	3) Takes Place only on Capital Account.
4) Above the line item.	4) Below the line item.